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The General Provisions of the Chinese Contract Law from a Scots Law Perspective

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A. Introduction

I begin with an observation on the idea of a peculiarly Scottish perspective on Chinese contract law. I suspect that many Chinese lawyers assume (without ever being contradicted by English lawyers) that English law and UK law are one and the same. Some of the Chinese legal scholarship I have read certainly speaks of ‘UK law’ and ‘British law’ without differentiating between the three legal systems operating within the United Kingdom, those of England and Wales (a unified system), Northern Ireland, and Scotland. The last of these, the Scottish legal system, is not a wholly Common law system. As a mixed legal system, it has in some respects more affinity with Chinese law than it does with English law, although one finds very little, if any, mention of Scots law in Chinese comparative legal scholarship. It is their shared mixed legal nature which makes the contract law of the two systems especially interesting for comparative purposes.

China has been characterised as a mixed legal system in which two prominent mixes are Civil Law and customary law,¹ but there are also socialist and Common law influences. Scotland has a mixed system in which the Civil Law and the Common Law are the most important influences, though others have played a role too (including Nordic law,² customary law, and the canon law, from the last of which Scotland got its general enforcement of unilateral promises).

In the rules of both Chinese and Scots contract law one sees the mark of the Civilian and the Common law traditions. In Civilian terms, one finds in the Chinese Contract Law (‘CCL’) the principle of good faith (Article 6, and elsewhere), the *exceptio non adimpleti contractus* (Articles 66–69), *culpa in contrahendo* (Articles 42–43), third party rights (Article 64), and the *actio pauliana* (Articles 74–75), among others, and one does not find any requirement of consideration in order validly to contract; in Common law terms, the CCL has rules on anticipatory breach (Article 94(2)), fundamental or material breach (Article 94(4)), and foreseeability of loss as a break on recoverable damages (Article 113). In Scots law, one also finds a mixture of Civil and Common law rules, though historically the Civilian element was a little more muted: so there is no *culpa in contrahendo*, only a more limited remedy for wasted pre-contractual expenditure, and good faith plays a much more limited role; on the other hand, third party rights have long been established in Scots law. Some CCL and Scottish principles can be said to derive from both the Common and Civil law: freedom to contract is an obvious one, though general contractual enforcement in both of those legal families can be traced to a *pacta sunt servanda* approach which has its origins in the canon

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¹ See for that classification: the University of Ottawa’s JuriGlobe World Legal Systems project: <http://www.juriglobe.ca/eng/sys-juri/class-poli/sys-mixtes.php>; also Esin Öricü, ‘What is a Mixed Legal System: Exclusion of Expansion?’ (2008) 12.1 Electronic J of Comp Law.

² The property law applicable in the Scottish islands of Orkney and Shetland includes recognition of ‘udal tenure’, a form of land tenure having an ancient Norse derivation. Orkney and Shetland were possessions of Norway until the late fifteenth century, some six hundred or so years after the establishment of the unified Kingdom of Scotland around 841.

law.³

The CCL does not alone constitute the entire corpus of general contract rules. The Supreme People's Court ('SPC') has also adopted two binding Interpretations of Several Issues concerning the application of the CCL.⁴ The Interpretation instrument (No. 2) comprises thirty articles setting out the way in which the SPC will approach the resolution of certain contractual disputes. Article 2, for instance, provides that

Where the parties did not conclude a contract in a written or verbal form, but it may be inferred from the civil conduct of both parties that both parties intended to conclude the contract, the people's court may determine that the contract was concluded in 'any other form' as mentioned in paragraph 1 of Article 10 of the Contract Law, unless it is otherwise provided for by law.

The important articles of these interpretation instruments are often cited by the SPC in its decisions in relation to contract disputes. However, the focus of this chapter will be on the rules of the CCL itself.

The CCL has been described by one Chinese academic as 'one of the best pieces of legislation among existing Chinese private laws',⁵ particular praise being reserved for the General Part of the CCL (which is the focus of this chapter).⁶ As a pro-codifying Scots lawyer, I am generally envious of any legal system with a civil code, but this praiseworthy assessment needs to be tested. In the following discussion, I consider whether the general provisions of the CCL merit the high accolade given to them in the observation just quoted. Comparative observations are made by reference to Articles 1–8 of the General Part. Though these observations are often principally from the perspective of Scots law, some of what I discuss in relation to Scotland is also applicable to English law.

B. Comparative observations on the General Provisions of the CCL⁷

Article 1: This Law is enacted with a view to protecting the lawful rights and interests of contracting parties, maintaining social and economic order and promoting socialist modernisation.

Scots contract law rules and principles also seek to protect the 'lawful rights and interests of contracting parties'; indeed, that is the primary purpose of judicial enforcement of contracts. What rights and interests are 'lawful' may be debated: enforcement of performance of the contract according to its strict terms, or satisfactory redress for non-performance, is clearly the primary interest of each party (what can be called the 'performance interest'). And in Scotland there is an emphasis on performance remedies, to a degree not mirrored in the

³ There are texts in the *Corpus Iuris Canonici* supporting universal contractual enforcement, for instance Gregor. IX, Lib. 1, TIT XXXV *De Pactis* cap 1: 'all said peace should be preserved, pacts respected'; cap 3: 'one ought to conduct oneself with care, so that, that which is promised will be achieved'. See also the work of Cardinal Hostiensis, including his *Summa aurea* and *Lectura*.

⁴ See Interpretation (No 1) of the SPC on Certain Issues Concerning the Application of the CCL, in effect as of 29 December 1999; Interpretation (No 2) of the SPC on Certain Issues Concerning the Application of the CCL, in effect as of 13 May 2009.

⁵ S Han, 'A Snapshot of Chinese Contract Law from an Historical and Comparative Perspective' in L Chen and C H van Rhee, *Towards a Chinese Civil Code* (2012) 235–255, at 253.

⁶ By contract, the Special Part is described as 'weak and poorly drafted': *ibid*, at 253.

⁷ Adopted at the Second Session of the Ninth National People's Congress on March 15, 1999 and promulgated by Order No 15 of the President of the People's Republic of China on March 15, 1999.

Common law (e.g. specific implement is an ordinary and not exceptional remedy, available as of right). But there are other lawful interests served by contract law: for instance, the interest of each party in the co-operation of the other party to ensure the contract's purposes are carried out (reflected in a term implied into contracts requiring mutual co-operation, which ensures that, to some extent, the parties are not seen merely as adversaries⁸), and perhaps also in not being subject to abusive enforcement of contract rights (though this is debateable, given the decision of the House of Lords in *White & Carter (Councils) v McGregor*⁹) and in being given a second chance to remedy defective performance, where possible (see *Lindley Catering Co v Hibernian Football Club*,¹⁰ discussed below).

Does Scots contract law also have as a founding purpose the maintenance of social and economic order? Not explicitly (i.e. contract is perceived primarily as serving the interests of the parties and not society more widely), though one can argue that, by the courts upholding and enforcing bargains freely entered into by the parties, this has the secondary effect of supporting the flourishing of a market economy (social economic order) and hence of the general welfare: without contract law, there could be no freely undertaken commercial transactions, and so opportunities for wealth creation would be greatly curtailed. Scottish contract law also embodies values other than personal wealth-creation, and these can be seen as part of the socio-economic order: such values include equity and fairness (manifested in the content and application of certain default contract rules), honesty and fair-dealing, perhaps embodied in a wider idea of good faith (see the further discussion of good faith below), mutual exchange (in the law's enforcement of onerous contracts), and benevolence/liberality (in the law's enforcement of gratuitous contracts, and unilateral promises). So the self-interest of parties, directed at their own economic advancement, is not the only feature characterising the social economic order which contract principles and rules seek to advance in Scotland.

Evidently, Scottish contract law does not, as a body of law, exist to promote 'socialist modernisation'. However, there is no reason why specific contractual arrangements could not be used by individual parties to embody, as their freely chosen aims, socialist values or a socialist venture, perhaps a mutual society or commune established on socialist principles. A socialist framework is thus not a prohibited choice for parties to embody in their contract. But this would have to be the freely adopted choice of the parties, and in interpreting and applying any such contract the court would not be doing so in a socialist fashion.

In Scotland, though the values and principles of contract law are not codified, those values – discernible through court judgments and academic literature – reflect the reality of legal and wider life. By contrast, I am sceptical as to whether 'socialist modernisation' is in reality a value which one can really see reflected in modern China. The economic and social modernisation which is discernible in the country seems to have more to do with urbanisation, economic expansion, and personal wealth creation, than it does with socialism.

Article 2: Contract, as referred to in this law, is an agreement whereby natural persons, legal persons or other organisations, as equal parties, establish, modify and extinguish relationships of civil rights and duties.

Agreements concerning civil status such as marriage, adoption and guardianship are governed by other laws.

⁸ *Scottish Power plc v Kvaerner Construction (Regions) Ltd* 1999 SLT 721.

⁹ [1961] UKHL 5, 1962 SC (HL) 1, [1962] AC 413.

¹⁰ 1975 SLT (Notes) 56.

Article 2 does a number of things. It separates off the rules of family law into a separate field of law, thus making clear that agreements relating to family arrangements, which might otherwise have been seen as ‘contracts’ governed by general contract law rules, are *not* governed by such general rules but by separate rules. Scots law does the same thing, and indeed it also treats other forms of agreement as sufficiently specialist in nature that they are not governed by general contract rules, e.g. the agreement between those establishing a company – constituted in the memorandum and articles of association – is governed by the rules of company law and not contract law, though the instruments in question can be seen as a form of statutorily mandated contract. It is noticeable that such a separation off of company law contracts is not also made in this Article, though it is clear that such a separation does exist given the existence in Chinese law of a separate Company Law of 2013 which deals with the requirements of articles of association.¹¹ Other specialist areas of Scots contract law, for instance the laws concerning sale, hire, lease, employment, and so forth, while having their own special rules are nonetheless seen as also governed by general principles of contract law to the extent that these general principles do not conflict with the specialist rules applicable in each area. China too has some separate legal instruments dealing with particular contracts, e.g. its Labour Law of 1995 and Employment Contract Law of 2008.

The other important thing which Article 2 does is to specify the fundamental nature of contracts: they are agreements, specifically agreements establishing, modifying, or extinguishing a civil rights-duties relationship between parties. This matches reasonably well with the conception of the nature of contract in Scots law, which is seen as resting in the idea of an agreement between parties intended to give rise to rights and duties in civil law (often, though not necessarily, adopted through a process of offer and acceptance¹²). Authority for this may be found in academic writing (much of it of some antiquity) and in courts’ pronouncements on contract disputes. On this matter, not only is Scots law in agreement but so also are European legal systems generally, as may be seen in model legal instruments embodying a European understanding of the law across systems (such as the Principles of European Contract Law and the Draft Common Frame of Reference). The description of a ‘relationships of civil rights and duties’ essentially identifies contract as one form of civil juristic act (or juridical act), i.e. an act recognised as having legal force. Such a concept is well-known in Civilian systems, and is beginning to find a clearer recognition in Scots law too.

A definition of contract as agreement-based is a deviation from the promissory conception of contract which remains quite prevalent in a number of Common law jurisdictions, including the US Common Law states. In such jurisdictions, alongside descriptions of contracts as enforceable agreements, one also finds statements that a contract is an exchange of promises or a promise in exchange for which some executed consideration has been received. The CCL eschews any promissory language, and so generally does Scots law. Because in Scotland there is a separate class of voluntary obligation called ‘promise’ (or ‘unilateral promise’), Scots lawyers avoid using promissory language to describe contract; doing so would create confusion with the separate form of unilateral promissory liability.

The one thing that is perhaps missing from the CCL’s agreement-based definition of

¹¹ Promulgated 28 December 2013.

¹² Chinese contract law also relies on an offer and acceptance analysis in relation to contractual agreement: see Article 13 of the CCL. For case law applying this analysis, see for instance the decision of the Supreme People’s Court in *Li Deyong v Chongqing Yunyang Sub-Branch of Agricultural Bank of China* (29 September 2013), SPC Gazette, Issue 7, 2015.

the nature of the contract is that it is not specified that the agreement must be *intended* by the parties to have the force of law, or – to put it another way – that in making the agreement the parties are demonstrating *consent* to be bound at law. That is a requirement which is conceived of as necessary in Scots law, a strong emphasis being placed on identifying the objective will of the parties to be bound at law to an agreement. This is consistent with the classification of contract in Scotland as a species of voluntary obligational relationship, i.e. one established as a result of the *voluntas* (free will) of the parties. The requirement that the agreement manifest the intention of the parties to be bound at law enables Scottish courts to deny legal effect to mere social arrangements (such as an ‘agreement’ to have dinner). The idea of an intention/consent to be bound is missing from Article 2, although one could describe both Articles 4 and Article 8 (discussed below) as fulfilling a similar role, Article 4 providing for a will-based entitlement to enter into contracts, and Article 8 providing that contracts ‘concluded according to law’ are legally binding. One can extrapolate from these provisions, taken together with Article 2, that whether contracts are formed in writing or orally (and we learn from Article 10 that, in general, parties may choose whichever form they wish), the binding force of agreement is demonstrated from an expression of the will of the parties, either in oral or written form, that the agreement take legal effect as a contract.

Article 3: Contracting parties are equal in their legal status, and no party may impose his own will upon the other party.¹³

In designating parties as being ‘equal in their legal status’ this Article is rather ambiguous in what it asserts. If it is asserting simply that parties are entitled to *equal treatment* before the law, i.e. that neither is to be given any preferential treatment by the courts, and that the rights of one party under a contract are of equal legal standing to the rights of the other, then the Article is wholly unexceptional in reflecting a basic tenet of the rule of law also applicable in Western legal systems. If, on the other hand, the Article is asserting that parties are of *equal bargaining position*, and cannot use any economic or other advantage they may have in trying to obtain a preferential deal for themselves, then what the Article is stating is noticeably different from the basic position adopted by Scottish contract law.

Some scholars have argued that both of these aspects may be encompassed by Article 3: so, Professor Mo Zhang has expressed the view that the equal status doctrine has three aspects to it, these being (1) equal capacity to undertake transactions, (2) equal treatment before the law, and (importantly) (3) ‘equality in negotiation’.¹⁴ On the other hand, Professor Bing Ling has asserted that equality in status ‘does not imply that the parties must be equal in their control of economic, social and intellectual resources, nor does it require that the contract concluded by the parties must be an exchange of equal value’,¹⁵ which rather suggests the Article is *not* concerned with an equality in bargaining position. He argues that what Article 3 is really asserting is only the freedom to compete on an equal footing in the marketplace, something which is an adjunct to the principle of voluntariness and so (in his opinion) would be better located within the text of Article 4.

If the Article is intending to assert equality in bargaining position, then it must be observed that in Scots law there is no presumption that, or rule requiring that, parties enjoy an

¹³ Articles 3 and 4 of the CCL have their origin in Article 5 of the Economic Contract Law of 1981. Article 5 provided that ‘In concluding an economic contract, the parties must follow the principles of equality and mutual benefit and agreement through consultation. No party may impose its own will on the other party, and no unit or individual may illegally interfere’.

¹⁴ Mo Zhang, *Chinese Contract Law: Theory and Practice* (2006) 72–73.

¹⁵ Bing Ling, *Contract Law in China* (2002) 42.

equality in their bargaining position or, in consequence, in the content of the contract which they conclude. On the contrary, the classic contract law view of the parties' positions is (with some rules softening the edges of this view) an adversarial one, with each conceived of as entitled to try and profit as much as possible out of the relationship, even at the expense of the other party. A party with a greater bargaining strength over the other is entitled to use it to persuade the other to accept less favourable terms than it might otherwise have accepted had it been in a stronger position, save to the extent that specific types of improper influence are forbidden at law. Such forbidden influence includes lying in order to persuade someone to contract or to contract on specific terms (fraud, misrepresentation), extorting a contractual advantage from another (extortion, force and fear), abusing a position of trust one holds in relation to another to derive an unwarranted advantage (undue influence), or tricking a weak-minded party into contracting to its disadvantage (facility and circumvention). In addition to these common law doctrines, there is some statutory regulation of the negotiation and content of contracts, for instance in consumer protection legislation specifically designed to protect the typically weaker consumer, and in unfair contract terms legislation. But these are exceptions to the general rule that a party is free to derive the maximum benefit it can when negotiating and entering into a contract. Consistent with that view, there is no entitlement of courts to amend or terminate contracts simply because the relationship entered into is unequal or unbalanced as a result of the inequality of the bargaining power of the parties. The attempt of Lord Denning¹⁶ to construct a general doctrine of inequality of bargaining power in English contract law was disavowed by the House of Lords in its decision in *National Westminster Bank plc v Morgan*,¹⁷ and Lord Denning's view was not adopted in Scotland. By contrast, and consistent with Article 3, Article 54 of the CCL allows a party to request a court to alter or rescind a contract which is 'evidently unfair' at the time of its conclusion. Such a general fairness based plea would not be maintainable before a Scottish court.

Some would argue that the traditional adversarial model of contract negotiation and formation is unfit for the modern age. Increasingly, it is argued that the principle of good faith ought to, and does, provide a basis for a more general regulation of parties' conduct and rights, such that some imbalanced relationships can be subject to moderation by the courts. This is discussed more fully under reference to Article 6 below. The arguments about the desirable role of good faith in modern law have a connection with earlier natural law ideas about the equality of parties to contracts: in the Aristotelian legal and moral tradition, commutative justice required that there be an equality in parties' relationships (including in their contracts). This ancient tradition was continued into early modern European legal scholarship, with examples of it being found in the writings of the Dutchman Hugo Grotius (who asserted that the law of nature enjoined that contracts are characterised by equality¹⁸) and of James Dalrymple (Lord Stair), Scotland's most famous jurist. Stair, in discussing contracts of exchange, asserted that it was 'the purpose of the contractors ... to keep an equality in the worth and value of the things'¹⁹ exchanged. Statements such as these suggest that an equality in the *substance* of the parties' positions should be maintained in contract.

In fact, however, these natural law statements in both Grotius and Stair were a mere Aristotelian veneer: when each writer developed his thinking on the parties' relative positions, the idea was advanced that what constitutes an equal exchange is whatever measure the parties freely choose for such exchange. So, Stair says 'the equality required in

¹⁶ See *Lloyds Bank Ltd v Bundy* [1974] EWCA Civ 8.

¹⁷ [1985] 1 All ER 821.

¹⁸ Grotius, *De iure belli ac pacis*, II.xii.8–13.

¹⁹ Stair, *Institutions of the Law of Scotland*, I.x.14.

these contracts [of exchange], cannot be in any other rate than the parties agree on'.²⁰ By the end of the seventeenth century, there was an emerging European and Scottish legal view that contract law could not generally police whether parties had received an equal exchange under their contracts: whatever the parties themselves decided was to be treated as an equality between them. That emerging view set the stage for a more aggressive, adversarial understanding of the relationship between negotiating parties.

If Professor Ling is correct, and the idea of equality of the parties is no more than an adjunct to freedom to contract, one simply asserting that parties compete on an equal footing in the market place, then Article 3 is unexceptional and reflects the view of Scots law. If, on the other hand, it does more than this, and represents an attempt to provide a general control against abuses in the bargaining process, then there is some gulf here between the CCL and the more limited rules against unfair, exploitative conduct in Scots law.

Article 4: Parties enjoy, according to law, the right to voluntarily conclude contracts, and no unit or individual may illegally intervene therein.

Ignoring for a moment the somewhat cryptic 'according to law' caveat, this article confers on parties a right voluntarily to enter into contracts. The principle of respect for voluntariness found in this Article had already been embedded in Chinese law before the adoption of the CCL: it is found in Article 4 of the General Principles of the Civil Law of the People's Republic of China (adopted in 1986), an article which has previously been cited by the courts as justification for allowing parties to enter into new sorts of contractual relationships, even where no existing provision of the law provided for the form of relationship in question.²¹

So, there is a clearly conferred freedom *to* contract under the CCL. But this is not the same as freedom *of* contract. Freedom *of* contract is the principle that parties may freely determine the content of any contract which they enter into.²² Most legal systems purport to confer not just freedom to contract, but freedom of contract, though in reality the degree of legislative and judicial policing of the content of contracts in the modern world must raise a serious doubt as to whether freedom of contract as an idea can still realistically be maintained in a pure form (if indeed it was ever realistic to do so).

So, this Article says nothing about freedom *of* contract, and scholarship suggesting it *does* has not paid sufficient attention to the distinction between freedom *to* contract and freedom *of* contract.²³ Some Chinese scholars have noted this, and have argued that the reference in the Article to voluntariness is deliberately *not* a reference to freedom *of* contract (indeed, an early draft of the Article, which used the language of freedom of contract, was

²⁰ Ibid.

²¹ See *Huitong Sub Branch v Fulida Co* (16 December 1997), SPC Gazette, Issue 2, 1998 (decision of the Higher People's Court of Heilongjiang Province). The principle has also been applied to circumstances where a party decided not to renew an existing contractual relationship: *Deng Jie v Shanghai Yaohua Pilkington Glass* (1994) (decision of Shanghai Intermediate People's Court).

²² It is often asserted that freedom of contract derives from the classical will theory of the post-Enlightenment period (Chinese authors make this point, as well as Western commentators: see, for instance, Junwei Fu *Modern European and Chinese Contract Law: A Comparative Study of Party Autonomy* (2011) 55), but Scots law had a developed doctrine of the will (*voluntas*) as the basis of contract by the time of Stair in the late seventeenth century. This is often overlooked, by virtue of a focus on English law at the expense of its Northern neighbour.

²³ So, the assertion by Zhang Yuqing and Huang Danhan, in their article 'The New Contract Law in the People's Republic of China and the UNIDROIT Principles of International Commercial Contracts: A Brief Comparison' (2000) 3 *Rev dr unif* 429 at 431, that Article 4 is much like Article 1.1 of the UNIDROIT Principles (which provides that '[t]he parties are free to enter into a contract and to determine its content' misses the point that Article 4 of the CCL does not mention the parties' right to determine the content of the contract.

replaced by the language of ‘voluntarily concluding’ a contract).²⁴ As we shall see, the content of Articles 5, 6, and 7 suggest that Chinese contracting parties do *not* have complete freedom to determine the content of their contracts. The interesting question is whether the restrictions applicable to freedom of contract in China are any greater than those in modern Scotland.

Although freedom *of* contract is not specifically protected under Article 4, there are decisions of the courts which appear to show a degree of respect for such freedom. So, in a case from 2013,²⁵ the SPC held that an agreement as to the payment of engineering costs was enforceable, even though this agreement was inconsistent with the findings of a statutory audit. The SPC held that the agreement did not violate mandatory provisions of law or administrative regulations (as noted earlier, this would have made the contract invalid under Article 52), and so was to be enforced according to its terms.

Lawful intervention with freedom to contract by other parties is permitted: this is presumably intended to include courts exercising jurisdiction in relation to disputes about contract formation, and to other persons or bodies who may be in a position of authority over a putative contracting party.

It is not entirely clear what the ‘according to law’ caveat adds to this Article: all rights are presumably only exercisable pursuant to law, so why need such a caveat be added to this particular right? To this observer, it looks as if the answer to why this wording was included may be that it was intended either as a reference to a normative understanding that the very freedom to contract is a power conferred by the law, or else to serve as a marker to other Articles of the CCL which limit the parties’ freedom, albeit that such other articles – for instance Articles 3 (equal status), 5 (fairness), and 6 (good faith) – focus more on limitation on the freedom *of* contract rather than freedom *to* contract. The growth of statutory limitations on absolute contractual freedom is taking the Scottish law nearer to the Chinese position, and it may be that, in focusing on freedom *to* (rather than *of*) contract, the CCL gets close to expressing what is the reality of modern contract law in Scotland, especially in the consumer field.

Article 5: The parties shall observe the principle of fairness in determining their respective rights and duties.

This Article seems to require parties to look not just to their own interests when seeking to determine their rights and duties, but to the other parties’ interests too: that at least is the implication of a duty to observe a ‘principle of fairness’ in determining the content of contracts. It seems thus to make provision for a process which is intended to lead to the result specified earlier in Article 3, namely the equality of the parties. Without using the term ‘good faith’, both of Article 3 (equality of the parties) and 5 (a fair formation process) could be seen as more specific manifestations of such a principle of good faith at the contract formation process, though it might have been more logical to place Article 5 (the process) before Article 3 (the relational status: equality). By contrast, Article 6 stipulates an explicit requirement of good faith at the enforcement stage of the contractual relationship.

In Article 5’s stipulation of a rule of equitable conduct applicable to the formation of contracts, the Article is expressing a rule which also applies, as a result of the doctrine of good faith, to the contract formation process in a number of Civilian systems (including

²⁴ Junwei Fu, *Modern European and Chinese Contract Law* (n 22) 40.

²⁵ *Chongqing Construction Engineering Group Corporation Limited v China Railway 19th Bureau Group Co Ltd* (20 March 2013), SPC Gazette, Issue 4, 2014.

Germany, for instance). This sort of rule is not however a rule of Scots law, where equity and good faith have a more limited role. As noted earlier under the discussion of Article 3, Scots contracting parties are generally entitled to prefer their own position to that of the other negotiating party, and, consistent with this, are not seen as being under specific positive duties to act fairly when determining each other's rights and duties (albeit that active unfairness is penalised).²⁶ So, there is no general duty resting on negotiating parties to furnish the other party with information which it might need in order to come to an informed decision on whether or not to enter the contract, or (if so) on what terms.²⁷ By contrast, German law imposes duties of disclosure at the negotiation stage (known as *Ausklärungspflichten*). These duties are conceptualised as an aspect of the special relationship which comes into existence when parties begin to negotiate a contract, such a relationship imposing on the parties a duty 'to take account of the rights, legal interests and other interests of the other party'.²⁸ Such a duty has the appearance of a more extended version of the duty of fairness specific in Article 5. The similarities suggest a clear connection with the Civilian approach to the relationship between negotiating parties, and make for a marked difference with both Scots as well as English law.

Article 6: The parties shall observe the principle of good faith in the exercise of their rights and performance of their duties.

Good faith is a principle which, in the abstract, is of considerable breadth and some inexactitude. In Scotland (and elsewhere in the UK) it has often been equated with honesty, openness, and fairness. In China it has, in somewhat similar terms, been described as incorporating the 'principle of honesty (*chengshi*) and faithfulness (*xinyong*)',²⁹ with the caveat that it goes far beyond the implications of these two words. The Chinese emphasis on faithfulness is entirely understandable, given that it is good *faith* (*fides*) which is at issue. Arguably, the very nature of contract as a form of obligation can be said necessarily to incorporate fidelity: we must be faithful to that to which we are bound in law. Consistent with this, there are decisions of the Chinese courts in which an absence of good faith is applied simply to describe a breach of contract.³⁰

The Scottish and Chinese jurisdictional understandings incorporate two perspectives of good faith, its subjective perspective (personal honesty) as well as its objective nature (adherence to community norms and ethics³¹). The DCFR combines both perspectives in stating that '[t]he expression 'good faith and fair dealing' refers to a standard of conduct characterised by honesty, openness and consideration for the interests of the other party to the

²⁶ Active unfairness is prevented by means of the doctrines discussed earlier under discussion of Article 3 (e.g. misrepresentation, extortion, etc.), but the law has not yet developed much beyond this stage.

²⁷ UK law has limited, targeted duties in relation to the provision of information, for instance in consumer credit contract and insurance contracts.

²⁸ BGB §241(2). The DCFR contains more specific duties requiring the provision of information by business parties: see DCFR, II.-3:101 ff.

²⁹ Ling, *Contract Law* (n 15) 52.

³⁰ See, for instance, the judgment of the Intermediate People's Court of Tianjin Municipality in *Liming v Zhu Jinhua and Li Shaohua* (26 December 1994), SPC Gazette, Issue 2, 1995, in which a refusal to pay a contractually stipulated reward was described as in violation of the principle of good faith.

³¹ For instance, trade practices can form the standard of good faith to which a party is required to adhere: see *Beijing Zhongrui Cultural Co Ltd v Beijing Zero Market Investigation & Analysis Co Ltd* (17 December 1998), SPC Gazette, Issue 3, 1999.

transaction or relationship in question'.³² As is the case in the DCFR,³³ the Article 6 duty is framed as an absolute one, unable to be modified or excluded by the parties.

The status and role of good faith in Scots contract law is a matter of uncertainty and debate. While in a Scottish appeal to the House of Lords reference was made to 'the broad principle in the field of contract law of fair dealing in good faith',³⁴ this statement has not found much explicit support in later Scottish case law; on the contrary, one judge (Lord Glennie) recently said that 'it is, of course, no part of Scots law that, in the absence of agreement, parties to a contract should act in good faith in carrying out their obligations to each other'.³⁵ The truth probably lies somewhere between these two positions: good faith in Scots law may be seen as a principle capable of explaining and connecting existing contract rules and doctrine, but its active role (in creating new duties or rules) is limited, albeit, as Lord Glennie says, that parties may *expressly* frame their duties by reference to good faith.

Article 6 of the CCL goes further than existing Scots (and English) law in embedding good faith at the performance/enforcement stage into contract law; the Scottish courts have seldom given any signs that they are willing to accept that parties are implicitly constrained in the exercise of their rights and duties by reference to good faith. Thus, in the famous decision of *White & Carter (Councils) v Macgregor*,³⁶ a contracting party was held by the House of Lords to be entitled to tender a performance which the other party had indicated it no longer wanted and to claim the price for so doing. One may debate whether such an entitlement is contrary to the principle of good faith (it has certainly been argued to be so), but the decision remains good law at the present time. On the other hand, a less formalistic approach is discernible in *Lindley Catering Co v Hibernian Football Club*,³⁷ in which the judge expressed the *obiter* view that, if a breach of contract is remediable, the victim of the breach must give the party in breach a second chance to remedy the defect (an approach which equates to the second chance or '*Nachfrist*' rule of German law³⁸). Such a view could be said to reflect the idea that contractual remedies must be exercised in good faith. Admittedly, this was only a first instance judgment, and an appeal level court has not definitively expressed a view on the matter. The safer view is that the *Lindley Catering* good faith based limitation on termination cannot be taken to represent the definitive view of Scots law, and that contractual rights must be taken to be exercisable in an unrestrictive fashion, unless agreed otherwise.

Potential weaknesses in Article 6 are its inherent vagueness and its uncertain interaction with other articles. One can of course point out that the terms of Article 6 specifically apply good faith to the exercise of rights and the performance of duties: the enunciation of such a specific role makes it easier to delineate the concept of good faith. But does the specification of this role mean that good faith has *no* role to play outside of the article? Arguably (and it has been so argued earlier), other provisions within the CCL can be seen as more specific crystallisations of the good faith principle³⁹ – Articles 3 (equality of status) and 5 (fairness in the formation process) – and some undoubtedly are so, in that they

³² DCFR I.-1:103(1).

³³ DCFR, III.-1:103(2).

³⁴ The comments of Lord Clyde in *Smith v Bank of Scotland* 1997 SC (HL) 111.

³⁵ Remarks of Lord Glennie in *EDI Central Ltd v National Car Parks Ltd* [2010] CSOH 141, at para 23.

³⁶ [1961] UKHL 5, 1962 SC (HL) 1, [1962] AC 413.

³⁷ 1975 SLT (Notes) 56.

³⁸ See §323 BGB.

³⁹ This view has been advocated by Chinese commentators too: see, for instance, Li Wei, 'On the Principle of Good Faith in Contract Law' (1999) *Journal of the Southwest University of Political Science and the Law* (issue 2) 31 ('新《合同法》不仅将诚实信用原则规定为合同订立和履行的基本原则，更重要的是在合同法的总则和分则特别是总则中的许多条款中都规定诚实信用原则的具体适用规则').

expressly mention good faith: these include Article 42 (the rough equivalent of the Civilian idea of *culpa in contrahendo*) and Article 60, the latter providing that '[t]he parties shall observe the principle of good faith and perform such duties as giving notice, providing assistance and maintaining confidentiality in accordance with the nature and purpose of the contract as well as the usage of transaction'. Yet, despite the generality of Article 6, most performance/enforcement articles in the CCL do *not* mention good faith. So, for instance, good faith is not mentioned in relation to performance towards a third party (Article 64), suspension of performance (Article 68), or refusal by the creditor of partial performance (Article 72). Is the absence of a good faith requirement in those provisions to be taken as a sign that what they stipulate or permit is *not* subject to the requirement of good faith? Or does Article 6 nonetheless reach into those provisions too? There is ambiguity here, which is unfortunate.

Article 7: When concluding and performing contracts, the parties shall comply with laws and administrative regulations and respect public morals, and they shall not disturb the social and economic order or harm the public interest.

This provision of the CCL has a lot packed into it, some of it being uncontroversial from a Scottish perspective, but other portions going further than Scots law.

There is no doubt that Scottish contracting parties must abide by the law (whether in the form of statutory rules, or rules deriving from secondary legislative instruments) in making and performing contracts. But a breach of the law by a contracting party may have one of a number of effects: it may render a contract unenforceable, if the doctrine of illegality is engaged; it may render the contract void or voidable; or it may have no effect on the contract at all. The first result (unenforceability) would obtain if, for instance, the contract was to do something illegal (e.g. to smuggle goods across a customs border); the second result (voidness or voidability) would obtain if the contract was tainted by some reprehensible conduct directed towards the other party, e.g. if extortion was present (the contract would be void) or a party was subject to undue influence or misrepresentation (the contract would be voidable); the third result would obtain if the breach of the law was merely tangential to the performance of the contract (e.g. if it transpired that, in delivering goods to a buyer, the seller had been exceeding the speed limit in its delivery vehicle). Some of the law surrounding these issues is muddled and in need of restatement (e.g. the rules on illegality), while other parts are settled and not in much, if any, doubt. It is striking that Article 7 says nothing about which effect results from specific breaches of laws or regulations. In fact, later provisions of the law address the issue of specific defects and their results. Article 52 prescribes a single effect – voidness – where any of the following pertain: (1) where a party uses fraud or duress to conclude the contract, thereby harming the interests of the state; (2) where it involves malicious collusion to harm the interests of the state, a collective organisation or a third person; (3) where it conceals an illegal purpose in a lawful form; (4) where it violates the public interest; or (5) where it violates mandatory provisions of laws or administrative regulations. Article 7 thus has the appearance of a general expression of principle, the practical effects of which are worked out later in the law.

The reference in the Article to 'public morals' is worthy of note. To a limited extent, public morality is taken account of in Scots contract law. Contracts which are *contra bonos mores* (against good morals) are (like contracts tainted with illegality) unenforceable, that is to say they strictly exist but neither party gains any enforceable rights under them. Gambling contracts used to be one example of such contracts, but the law was changed in 2005 to make

them enforceable.⁴⁰ Another example is contracts of prostitution, which remain unenforceable. The idea of subject matter which is *contra bonos mores* is evidently a culturally and temporally specific one, as the legitimization of gambling indicates. As a concept for controlling socially unacceptable conduct, there is the danger that it can be used to persecute conduct which, though disapproved of by authority, is not objectively harmful.⁴¹ In the wrong hands therefore, it could be an oppressive doctrine used to prohibit conduct which may not be contrary to any express provisions of the law. It does not feature in much, if any, modern Scottish case law, suggesting that its importance has greatly diminished over time.

As for parties not disturbing the social and economic order or harming the public interest, these strike me as remarkably vague ideas. What is the ‘social and economic order’, and how might it be disrupted? If it means state socialism, then one might have thought that any private contractual relationships could arguably disrupt such order, but that can clearly no longer be so or there would be no CCL of the sort under examination. Of course, all legal systems have laws which target specific conduct deemed to be contrary to the good functioning of society or economy: rules against insider dealing, and anti-trust regimes, are two examples. But the specificity of these rules is what gives them a sphere of certain application. A rule of the sort in Article 7 strikes me as too vague to provide any benefit that does not carry with it the danger of being used repressively. Again, what is the ‘public interest’? It might conceivably extend to consumer protection, but again one would expect specific rules to be developed to afford such protection; the all-encompassing phrase used in Article 7 seems far too much of a blunt instrument. A more specific rule is needed to ensure that parties can act with legal certainty when undertaking transactions and structuring their affairs.

Article 8: Contracts concluded according to law are legally binding on the parties. The parties shall perform their respective duties in accordance with the agreement and may not unilaterally modify or terminate the contract.

Contracts concluded according to law are protected by law.

As a preliminary observation, it is not clear to me what the second statement – ‘Contracts concluded according to law are protected by law’ – adds to what has already been said earlier in the Article. The first stated rule of the article, that ‘contracts concluded according to law are legally binding on the parties’, would seem to have precisely the effect of legally protecting such contracts. The later statement thus seems to do no more than paraphrase what has already been said, and could I think easily be dispensed with. Indeed, more broadly, the CCL as a whole is an instrument which protects lawfully concluded contracts.

As to the initial statement, conferring binding force on lawfully concluded contracts, this is an uncontroversial basic statement of the normative force of contracts, one reflected in Western legal systems in the maxim *pacta sunt servanda* (contracts are enforced). In the way in which it is specifically framed, however, it can be argued that the CCL locates the normative force of contracts in the legislative will: the legal force of a contract does not

⁴⁰ See Gambling Act 2005, s 335.

⁴¹ In this regard, the case of *X v Y*, a decision of the Naxi District People's Court, Luzhou, Sichuan Province, from 2001 (Naxi Minchuzi No 561), discussed by Professor Han in his chapter of this work, may be noted: the court denied the legal validity of what appeared to be a valid testamentary bequest by a deceased man to his mistress on the basis that the bequest was contrary to public morals (and thus contrary to Article 7 of the General Principles of the Civil Law, which is drafted in similar terms to Article 7 of the CCL).

depend on the will of the parties, rather the consent of the parties to be bound at law is met with the response by the state that the contract is to be afforded validity and enforcement. The parties' wills are thus the mechanism by which contracts come into being in Chinese law, but their normative force derives from the will of the legislator, of the people one might say in communitarian fashion. This is not so different to what can be said of Scots law: I have previously argued that the only defensible view of the role of the will in modern contract law, in an era when so much of the content of contracts derives from default rules and implied terms at law, is to see it as the mechanism through which contracts become enforceable, rather than as their normative source.⁴² Parties consent to the imposition of contractual obligations on them by the law. On this view, Scots and Chinese contract law can agree.

The Article specifies that only the parties are legally bound by their agreement. This is consistent with the principle of privity (or relativity) of contract, also applied in Scots law. As an exception to the privity rule, in Scots law the conferral of directly enforceable rights upon extra-contractual third parties is generally permissible; under the CCL, the position is more convoluted, Article 64 only providing that failure to perform in favour of a third party makes the debtor liable 'to the creditor' (i.e. the other contracting party) for such breach. Academic views are that third parties *do* have the right to demand such performance themselves,⁴³ but the status of this position as mere academic opinion is unsatisfactory.

As for parties being 'required to perform their respective duties', this is a certainly a view consistent with Scots law, which places a high value on performance. In Scotland, specific implement (the equivalent remedy to specific performance in the Common law) is an ordinary contractual remedy, not an exceptional or equitable one, and the primary measure of contract damages is one which equates to the performance interest (and includes recovery of both *damnum emergens* and *lucram cessans*).

As for parties not 'unilaterally' modifying or terminating the contract, no contracting party may unilaterally modify a contract in Scots law, unless the contract gives it the power to do so; however, if a contract *does* confer a right of unilateral modification, then such a power can generally be exercised strictly according to its terms (in cases of doubt, an ambiguity would be likely to be read against the interests of the party which had been responsible for the drafting of the power). There is some protection however against unilateral modifications permitted under the contract: if the power conferred were to be deemed an unfair term, it might be struck down under either the applicable provisions of the Unfair Contract Terms Act 1977 or of Part 2 of the Consumer Rights Act 2015.

As to unilateral termination of a contract in Scots law, this is again permitted if the contract gives a party that power (though unfair terms law is also applicable to such a power, and may thus strike it down in some cases) or as a justified response to a material breach of contract by the other party (when it is often styled 'rescission'). In the CCL, unilateral termination is permitted in the circumstances specified in Article 94; otherwise, the Supreme People's Court (SPC) has held unilateral termination not to be permissible.⁴⁴ The right to rescind a contract granted under Article 94 must, unless a specified time limit is agreed, be

⁴² See Martin Hogg, 'Competing Theories of Contract: An Emerging Consensus?' in Larry DiMatteo et al, *Commercial Contract Law: Transatlantic Perspectives* (2013).

⁴³ See further Bing Ling, *Contract Law* (n 15) 254.

⁴⁴ See *Chengdu Xunjie Communications Chain Co Ltd v Sichuan Shudu Industrial Co Ltd. and Sichuan Youli Investment Holding Co Ltd* (14 November 2013), SPC Gazette, Issue 1, 2015. The SPC has however also held that, if both parties are in breach, unilateral termination is also possible: see *Wang Guangjun and Wang Guangli v Shandong Juye County Hengjie Environmental Protection Equipment Manufacturing Co Ltd* (1 February 2009), SPC.

exercised with a reasonable time (Article 95);⁴⁵ Scots law takes a similar view. The reasonable time stipulation of Article 95 has the appearance of a crystallisation of the more general rule of Article 8 against arbitrary termination as well as of the principle of good faith embodied in Article 6.

There is English case law supporting the view that discretionary powers granted to parties under contract must be exercised in a genuine, rational, and not arbitrary fashion,⁴⁶ and such a view would also be taken in Scotland. In terms of default remedies given to parties, including the common law power to terminate a contract, this can only be exercised if the other party is in material breach of contract, a material breach being one which goes ‘to the root of the contract’.⁴⁷ This restriction can be seen as moderating harsh or excessive exercise of a right to terminate, and is one of the features of the default rules of Scots law which have been argued to reflect a principle of good faith. We have also seen how at least one case suggests that parties which have committed a remediable breach of contract should be given the right to remedy the breach, though this rule is of very doubtful status.

In sum, the Scots law approach does not equate to a general prohibition against unilateral modification or termination, but there are more targeted rules which regulate specific instances of such conduct.

C. Conclusion on the overall character of the general principles of the CCL

What ought a Scots lawyer to conclude about the general rules (Articles 1 to 8) of the general provisions of the CCL?

First, taken at face value, they do seem to represent a mixture of Common law and Civil law, with a nod to ‘socialist modernisation’. The last of these is only referred to explicitly once in the CCL, and from what I can tell does not feature regularly (if at all) as a reference point in the decisions of the courts. That being the case, it’s hard to see what real impact socialist modernisation as a value can be expected to have on contract law (though Article 3’s notion of the equality of parties might be claimed to be representative of the spirit of socialism).

Of the general articles discussed above, some embody principles or rules found in both Civil and Common law: contract as agreement (Art. 2); freedom to contract (Art. 4); compliance with laws and public morals (Art. 7); and no unilateral modification or termination (Art. 8). One is clearly more reflective of Civilian ideas, that concerning good faith (Art. 6). None are especially redolent of Common law ideas, though (as noted earlier) some of the later provisions in the CCL are so. One article might be interpreted as going further than either existing Civil or Common law rules, namely Article 3 in its stipulation that parties are ‘equal in their legal status’, though it has been noted that there is a view that this article is in fact doing no more than saying that parties have an equal right to compete in the marketplace. The further aspect of Article 3 (that ‘no party may impose his own will upon the other party’) to some extent already reflects rules of the Common and Civil law, though as an unqualified and more general-in-scope rule, it has the potential for a more radical impact on

⁴⁵ See, for an application of this rule, *Tianjin Tianyi Industry & Trade Co Ltd v Tianjin Binhai Commerce & Trade World Co Ltd* (31 January 2013), SPC Gazette, Issue 10, 2013.

⁴⁶ *Paragon Finance plc v Nash* [2001] EWCA Civ 1466, *Lymington Marina Ltd v MacNamara & Ors* [2007] EWCA Civ 151.

⁴⁷ *Wade v Waldon* 1909 SC 571 at 576. There are other, similar formulations, for instance that a material breach is ‘of the essence of the contract’ (*Council of Johannesburg v D Stewart & Co (1902) Ltd* 1909 SC 860) or affects ‘the root and substance of the contract’ (*Graham v United Turkey Red Co* 1922 SC 533 at 536).

contractual arrangements than the more targeted rules of Western legal systems relating to unconscionable and unfair advantage-taking. The same can be said of Article 5's prescription of fairness in party conduct.

In general, as an outside observer of Chinese Contract Law it is difficult to gauge to what extent the law on paper reflects practice. It has been observed that, while the rules of the CCL mirror European legal principles, behind those rules lie traditional Confucian ethics (including the principle of *yi*, righteousness, which equates to some extent with the Western notion of justice⁴⁸) as well as Chinese cultural practices such as that of *guanxi*, or 'mutual obligation, reciprocity, goodwill and personal connection',⁴⁹ which can (to outside eyes) be perceived as favouritism of a sort deprecated in Western legal culture. That is not to say that Western contractual practice necessarily equates exactly to contract rules: relational contract theory has taught us that business people may ignore contract terms or their enforcement in favour of preserving the contractual relationship over the longer term. But the suspicion remains that favouritism in Chinese law, and the consequent divergence of law and reality, may be much greater in China than it is in the West, including in Scotland.

Some might worry that the very general principles embodied in the first eight articles have the potential to provide courts with the means to disrupt the agreements of parties as well as the later more specific rules of the CCL: statements that parties are 'equal' in status, may not 'impose' their will on each other, and must act 'fairly' in determining their rights and duties, delineate what are, *prima facie*, very sweeping, uncertain propositions and standards of conduct.⁵⁰ However, it seems that the Chinese courts have not permitted these potentially very disruptive general norms to run roughshod over party intentions or to disrupt the more focused later rules of the CCL. Rather, they are seen as a means to interpret later provisions of the Law, and serve (as do similar general provisions in European Civil Codes) to provide inspiration when the courts have to deal with gaps in the code. This is testified to by Professor Han, who remarks in his chapter in this book that the general principles function as keys to assist in interpreting the more specific later rules of the CCL as well as the means to supplement gaps in the CCL.⁵¹ This is consistent with the approach taken to general principles in codified Civilian and mixed legal systems.

Much of what the general principles prescribe is not dissimilar to the content of general rules in the UNIDROIT Principles, the DCFR, and the PECL, principles which are increasingly familiar to Scottish lawyers. Many of the general principles are also, as has been seen, comparable to rules of Scots law (with a few exceptions commented on above), though often these rules are more targeted in nature. A Scots lawyer will certainly not feel on unfamiliar territory in reading Articles 1 to 8 of the CCL, as a desire for foundational, general principles of contract law is one of the marks of a Civilian heritage shared by both the PRC and Scotland.

⁴⁸ See Junwei Fu, *Modern European and Chinese Contract Law* (n 22) 43.

⁴⁹ P Pattison and D Herron, 'The Mountains are High and the Emperor is Far Away: Sanctity of Contract in China' (2003) 40 Am Bus J 459–510, 484. See further, on the divergence of Chinese contract law and the practice of contracting parties, N Kornet, 'Contracting in China: Comparative Observations on Freedom of Contract, Contract Formation, Battle of the Forms and Standard Form Contracts' (2010) 14.1 Elec J of Comparative Law.

⁵⁰ '[F]undamental principles in the CLC ... are uncertain, because they do not refer to concrete rights and obligations of parties, with the effect that contractual parties cannot predict the precise consequences that these principles will have on their rights': see Junwei Fu, *Modern European and Chinese Contract Law* (n 22) 38.

⁵¹ See Shiyuan Han in ch 000, p 000.